



**BOARD OF COMMISSIONERS' CHARACTERISTIC AND
ACCOUNTING CONSERVATISM:
The Case of Manufacturing Company Listed in IDX**

SKRIPSI

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by

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ABSTRACT

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Conservatism has involved as part of an efficient contracting technology that helps in reducing deadweight losses resulting from agency problem. Because the Board of Commissioners understand the benefit of conservatism, they will more likely to advice and demand more conservative accounting in order to protect the shareholders' right. The objective of this study to examine relationship between of Board of Commissioners' characteristics and Accounting Conservatism. This study takes sample from manufacturing companies that listed in Indonesian Stock Exchange (IDX) from 2004-2006. The conservatism proxy used in this research is first, accrual obtained from differences between Net Income and Cash flow. Second, market to book value ratio. Additional testing also did by combining both of measurement. Generally, the results showed that Board of Commissioners' size has significant relationship with Accounting Conservatism. Oppositely, The Board of Commissioners' composition has insignificant relationship with Accounting Conservatism. The results of this study have revealed that Accounting Conservatism assisting Board Of Commissioners in reducing agency costs of firms..

*Keyword: Board of Commissioners' characteristics, Conservatism,
Agency costs.*

CHAPTER I

INTRODUCTION

1.1 Background

Until now, conservatism still have important role in accounting practice. Conservatism defined as the differential verifiability required for recognition of profits versus losses. In its extreme form the definition incorporates the traditional conservatism adage: "anticipate no profit, but anticipate all losses." (Bliss 1924 c.f. Watts 2002).

For many years, accountant have been influenced by conservatism in a reaction to uncertainty. Conservatism in accounting may mislead users if it results in a deliberate understatement of net assets and net income. Such understatement is undertaken to minimize the risk of uncertainty to outside lenders. The existence of conservatism will be different for each companies because many alternative methods of accounting can be used.

In fact, conservatism is one controvesial concept. Many contradictions about conservatism usefullness. The criticism argue that conservatism will make equity book value become bias (Monahan 1999 cited from Mayangsari and Wilopo, 2002). Capital market regulator, standard setters, and academics criticize conservatism because the understatement of net asset values in the current period can lead to overstatement of earnings in the future periods by causing an understatement of future expenses. Despite criticism from many quarters, including standardsetters, conservatism appears not only to have survived in accounting for many centuries, but also to have increased in the last 30 years (Watts,2002)

In other words, different opinion states that conservatism will produce higher-earnings quality because this principle avoid the company to overstate profit and asset. Watts (2002) more explained that conservatism has benefit to parties associated with the firm. Conservative accounting is a means of addressing problems due to parties to the firm having asymmetric information, asymmetric payoffs, and limited liability as long as the reports' accounting measures is used to inform investor about managerial performance.

In the incentive compensation case, the management frequently has more information than the other parties to the company. Without having verifiable earnings measures, the management will be more likely to use unconventional (non-conservative) accounting to receive over payments that leave shareholders with a lower share value and the shareholders are unable to recover the over payment because of limited liability. Conservatively measured earnings provide some timely incentives and deferred compensation rewards managers for future cash flows (Watts 2002). Because of that, the shareholders like the company to be more conservative and Board of Directors who exist to protect shareholders' right will require verifiable information to monitor management and conservatism can facilitate it.

Watts (2002) also argued that conservatism likely evolved from the contracting role of accounting. Conservatism has envolved as part of an efficient contracting technology that helps in reducing deadweight losses resulting from agency problems.

As Indonesia adopted Continental European governance model, there are two boards in every companies within this country. Those are the Supervisory

CHAPTER V

CONCLUSIONS

5.1 Conclusions

This research investigates the relationship between Board of Commissioners' characteristic and conservatism of accounting. Conservatism is measured by using some proxies which are Net Asset Measurement; Earning/ Accrual Measurement; and additional test by combining of both measurements.

Generally, the result shows that Board of Commissioners' size has positive and significant relationship with conservative accounting by using all measures with the exception for the Earning/ Accrual Measurement without NI Criteria.

Surprisingly, the researcher found insignificant relationship between proportion of independent commissioners and accounting conservatism for all measures. This result is inconsistent with empirical finding of Ahmed & Duellman (2007) and Haslinda (2007) who found positive relationship between proportion of independent commissioners and accounting conservatism.

It can be conclude that Board size has more important role in monitoring and controlling the managements' behavior in Indonesian (Kusumawati and Bambang, 2005). It can be seen from general statistical result whereas the relationship is not only significant but also positive. Oppositely, the independence commissioners has insignificant relation with conservatism. The result of this study have revealed that accounting conservatism assisting Board of Commissioners in reducing agency costs of firm.

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